

Eligibility  
Farming operation  
Non-recourse  
11 U.S.C. § 101(18)(A)  
11 U.S.C. § 502(b)(1)  
11 U.S.C. § 506(a)

In Re Osborne

Case # 04-68795-aer12

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Radcliffe

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Prior to filing Chapter 12, Debtors received a Chapter 7 discharge in a case filed in the Eastern District of California. The effect of the discharge was to turn Farm Credit's secured claim into a non-recourse claim. In the present Chapter 12, Farm Credit filed a claim for over \$1,442,000. In moving to dismiss, it argued that its claim, when combined with the other claims in the case, put Debtors over the \$1,500,000 aggregate debt limit for eligibility purposes. Debtors argued that for eligibility purposes, its debt to Farm Credit should be limited to the value of Farm Credit's collateral, which Debtors had scheduled at \$480,500. Farm Credit also argued Debtors did not meet the "farming operation" requirement for eligibility.

Held: Motion to dismiss denied.

The court, relying on the rationale of Scovis v. Henrichsen (*In Re Scovis*), 249 F.3d 975 (9<sup>th</sup> Cir. 2001) held it appropriate to import a § 506(a) and § 502(b)(1) analysis into the eligibility determination, thereby limiting, for eligibility purposes, Farm Credit's secured claim to the value of the collateral, and because of the prior Ch. 7 discharge, refusing to count (as unenforceable) any remaining under-secured portion. The court distinguished prior 9<sup>th</sup> Circuit authority.

The court also examined Debtors' operations using the criteria set out in In Re Sugar Pine Ranch, 100 B.R. 28 (Bankr. D. Or. 1989), and held Debtors were engaged in a farming operation at the time of filing, and more than 50% of their gross income within the taxable year preceding the taxable year in which the petition was filed, was derived from such operation.

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

In Re: ) Bankruptcy Case No.  
 ) 04-68795-aer12  
BILL AND MARY OSBORNE, )  
 ) MEMORANDUM OPINION  
Debtors, )  
\_\_\_\_\_ )

This matter comes before the court on Northwest Farm Credit Services, FLCA's (Farm Credit) motion to dismiss. The matter has been heard and is now ripe for decision.

Facts:

Debtors Bill Osborne (Bill) and Mary Jane Osborne (Mary Jane) own various parcels of farmland in and around Tulelake, California. Bill is a third generation farmer, who historically farmed with his father, James Osborne (James), who owned nearby land. In 1994, Debtors and James jointly (along with a family trust) refinanced several pre-existing loans with Farm Credit. Farm Credit took security in the farmland, certain equipment and fixtures. Over the years various crops were grown on the land.

1           In the late, 1990s Debtors ran into financial troubles and  
2 filed a Chapter 11 bankruptcy in the Eastern District of California.  
3 Farm Credit was listed as a creditor. The case was later converted  
4 to Chapter 7 and Debtors received their discharge in August, 2000.  
5 Much of Debtors' farm machinery was either sold or otherwise  
6 disposed of in that case. Debtors' real property was abandoned by  
7 the Chapter 7 trustee.

8           In the early 2000s, Debtors suffered a lost mint crop when  
9 the Bureau of Reclamation shut off their water supply due to  
10 drought-like conditions. After the crop's loss, Debtors lacked  
11 operating capital and decided to lease the farmland, sometimes on a  
12 crop-share, sometimes on a cash, basis.

13           At some point, the Farm Credit loan went into default and  
14 foreclosure proceedings were commenced.

15           In March, 2003, Bill leased 155 irrigable acres to Woodman  
16 Farms, Inc. on a cash rent basis (the Woodman lease).<sup>1</sup> The lease  
17 terminates no later than November, 2008. Under the lease, Bill was  
18 to provide "pumps and power," and pay the real property taxes. Bill  
19 testified that he maintains the pumps and irrigation, and is on the  
20 leased property daily.

21           In 2003, Bill leased the balance of their farmland to Earl  
22 Schultz (the Schultz lease). The arrangement was originally on a  
23 cash basis. Bill testified that "it didn't turn out that way." Bill  
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26           <sup>1</sup> See, Farm Credit's Exhibit J.

1 furnished labor and maintained the irrigation equipment.<sup>2</sup> During  
2 calendar year 2003, more than half of Debtors' gross income was  
3 derived from the Schultz and Woodman leases.

4 At some point the Schultz lease terminated. In April, 2004,  
5 Bill leased 340 acres to Gene Dunlea on a 25% lessor/75% lessee  
6 "share" basis, over a six year term (the Dunlea lease).<sup>3</sup> The crop  
7 at the time Debtors' current bankruptcy petition was filed was in  
8 alfalfa. Under the lease, Bill was to provide "pipe, mainline,  
9 pumps, property taxes, water fees, and electricity for irrigation,"  
10 and was to "ensure all irrigation systems are inspected and in  
11 proper working order, at which time the lessee shall assume  
12 responsibility for operation and maintenance."<sup>4</sup> Bill testified  
13 however that he has maintained the irrigation pumps during the  
14 lease's term.

15 After an aborted Chapter 13 case, filed in September, 2004,  
16 Debtors filed the present Chapter 12 petition on November 8, 2004.<sup>5</sup>  
17 At the time the petition was filed, both the Woodman and Dunlea  
18 leases were extant.

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21 <sup>2</sup> Bill also testified he furnished some labor to Woodman.

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23 <sup>3</sup> See, Farm Credit's Exhibit K.

24 <sup>4</sup> The Dunlea lease also provided that "[i]n the event of a water shortage  
25 the lease amount shall be adjusted to a rate acceptable to both the lessor and  
26 the lessee. Likewise, the unknown change in power cost (2006) shall be worked out  
by the two parties at that time." Farm Credit's Exhibit K.

<sup>5</sup> James likewise filed a Chapter 12 petition the same day, which has  
subsequently been dismissed.

1 In their bankruptcy schedules in this case, Debtors listed  
2 \$555,223.51 in secured debt, listing the debt to Farm Credit at  
3 \$480,500, which was also listed as the value of the collateral  
4 securing the claim. They also listed \$1,221.95 in priority  
5 unsecured, and \$31,229.20 in general unsecured debt, listing Farm  
6 Credit at \$0.00 and as "disputed, unliquidated and contingent." They  
7 listed James as a co-debtor.

8 Discussion:

9 Farm Credit attacks Debtors' eligibility for Chapter 12  
10 relief. Chapter 12 eligibility is governed by § 11 U.S.C. §  
11 109(f)<sup>6</sup> which provides that "[o]nly a family farmer with regular  
12 annual income may be a debtor under chapter 12 of this title."

13 "Family farmer" is defined, in pertinent part, in §  
14 101(18)(A) as an:

15 individual or individual and spouse engaged  
16 in a farming operation whose aggregate  
17 debts do not exceed \$1,500,000 and not less  
18 than 80 percent of whose aggregate  
19 noncontingent, liquidated debts (excluding  
20 a debt for the principal residence of such  
21 individual or such individual and spouse  
22 unless such debt arises out of a farming  
23 operation), on the date the case is filed,  
24 arise out of a farming operation owned or  
25 operated by such individual or such  
26 individual and spouse, and such individual  
or such individual and spouse receive from  
such farming operation more than 50 percent  
of such individual's or such individual and  
spouse's gross income for the taxable year  
preceding the taxable year in which the  
case concerning such individual or such  
individual and spouse was filed.

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<sup>6</sup> Unless otherwise noted, all subsequent statutory references are to Title 11 of the United States Code.

1 Farm Credit argues Debtors exceed the \$1,500,000 "aggregate  
2 debt" limit of § 101(18)(A). It points to its proof of claim filed  
3 for over \$1,442,000, which, when combined with the other claims,  
4 puts Debtors over the limit. Debtors argue Farm Credit's claim is a  
5 "non recourse" claim as a result of their prior Chapter 7 discharge.  
6 As such, it is limited to the value of the farmland that serves as  
7 its collateral.<sup>7</sup>

8 The Ninth Circuit Court of Appeals has held, in the Chapter  
9 13 context, that "eligibility should normally be determined by the  
10 debtor's originally filed schedules, checking only to see if the  
11 schedules were made in good faith." Scovis v. Henrichsen (*In re*  
12 *Scovis*), 249 F.3d 975, 982 (9<sup>th</sup> Cir. 2001) (emphasis added). For  
13 this purpose, there does not appear to be any reason to distinguish  
14 between Chapter 13 and Chapter 12. Here, Debtors' schedules reflect  
15 their theory that Farm Credit's claim is limited to the value of its  
16 security.

17 For purposes of determining whether a  
18 particular schedule was filed in good faith  
19 in making the calculation under Code §  
20 109(e) [Chapter 13], the debtor's schedules  
21 do not dictate the outcome if it appears  
22 from other relevant facts, readily  
23 ascertained, that the amount of a scheduled  
24 claim is, as a matter of law, greater than  
25 the amount disclosed.

22 In Re Cookus, Case # 04-66814-fra13 (Bankr. D. Or. Dec. 30, 2004)  
23 (Alley, J.) (unpublished). Thus, the court must decide the extent

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25 <sup>7</sup> Debtors also sought to apportion their joint and several liability  
26 between themselves and James to bring them below the debt limit. It appears the  
majority, if not unanimous rule, is that Debtors may not do so. See e.g., In Re  
Walton, 95 B.R. 514 (Bankr. S.D. Oh. 1988) (Ch. 12); In Re Cronkleton, 18 B.R.  
792 (Bankr. S.D. Oh. 1982) (Ch. 13).

1 to which non-recourse obligations are counted for eligibility  
2 purposes, as a matter of law.

3 In Quintana v. Commissioner, (*In Re Quintana*) 915 F.2d 513  
4 (9<sup>th</sup> Cir. 1990), the Chapter 12 debtors made the same argument as  
5 the debtors advance here. There, the secured creditor (within a pre-  
6 petition foreclosure suit), waived any deficiency claim that might  
7 arise after a foreclosure sale of the real property collateral. The  
8 debtors then filed Chapter 12 before the sale. The court examined  
9 Idaho law, finding the creditor's waiver irrelevant until the sale,  
10 held the full amount of the creditor's claim (as opposed to the  
11 amount secured by the value of the real property collateral) was to  
12 be counted for eligibility purposes.

13 At first blush Quintana would appear to control. Almost  
14 eleven (11) years later, however, in Scovis, supra, the Ninth  
15 Circuit in reiterating that eligibility is determined on the date of  
16 petition, 249 F.3d at 981, held it permissible to import a

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1 § 506(a),<sup>8</sup> as well as a § 522(f)(1),<sup>9</sup> analysis into an eligibility  
2 determination. Id. at 983-984.<sup>10</sup> The court recognized that  
3 §§ 506(a) and 522(f)(1), by their literal terms, speak to  
4 postpetition events (i.e claim allowance and lien avoidance).  
5 Nonetheless, it refused to elevate form over substance. Id.

6 Following the Scovis rationale, the importation of a § 506(a)  
7 valuation is appropriate in this case. See also, Cavaliere v. Sapir,  
8 208 B.R. 784 (D. Conn. 1997). The only evidence that has been  
9 adduced as to the value of Farm Credit's collateral is Debtors'

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11 <sup>8</sup> Section 506(a) provides:

12 An allowed claim of a creditor secured by a lien on  
13 property in which the estate has an interest, or that is  
14 subject to setoff under section 553 of this title, is a  
15 secured claim to the extent of the value of such  
16 creditor's interest in the estate's interest in such  
17 property, or to the extent of the amount subject to  
18 setoff, as the case may be, and is an unsecured claim to  
19 the extent that the value of such creditor's interest or  
20 the amount so subject to setoff is less than the amount  
21 of such allowed claim. Such value shall be determined in  
22 light of the purpose of the valuation and of the proposed  
23 disposition or use of such property, and in conjunction  
24 with any hearing on such disposition or use or on a plan  
25 affecting such creditor's interest.

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<sup>9</sup> Section 522(f)(1) provides in pertinent part:

21 Notwithstanding any waiver of exemptions but subject  
22 to paragraph (3), the debtor may avoid the fixing of a  
23 lien on an interest of the debtor in property to the  
24 extent that such lien impairs an exemption to which the  
25 debtor would have been entitled under subsection (b) of  
26 this section, if such lien is--

(A) a judicial lien ....

<sup>10</sup> In Scovis, the issue was whether undersecured debt, and unsecured debt created by lien avoidance, should be counted as unsecured debt for purposes of Chapter 13 eligibility.

1 schedules, which value the property at \$480,500. Thus, Farm  
2 Credit's secured claim, for eligibility purposes, is \$480,500.

3 As to any "undersecured" portion (which would also be counted  
4 in the "aggregate" debt analysis), Farm Credit itself acknowledges  
5 any such claim is unenforceable because of Debtors' Chapter 7  
6 discharge. Id. (citing § 502(b)(1)<sup>11</sup>).<sup>12</sup> Thus, by importation of §§  
7 506(a) and 502(b)(1) in the § 101(18) analysis, Debtors' aggregate  
8 debts are under the \$1,500,000 threshold.

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10 <sup>11</sup> Section 502(b)(1) provides:

11 Except as provided in subsections (e)(2), (f), (g),  
12 (h) and (i) of this section, if such objection to a claim  
13 is made, the court, after notice and a hearing, shall  
14 determine the amount of such claim in lawful currency of  
the United States as of the date of the filing of the  
petition, and shall allow such claim in such amount,  
except to the extent that--

15 (1) such claim is unenforceable against the  
16 debtor and property of the debtor, under any  
17 agreement or applicable law for a reason  
other than because such claim is contingent  
or unmatured.

18 <sup>12</sup> As stated by the Cavaliere court (in the Chapter 13 context):

19 Much as courts have avoid[ed] the temptation to raise  
20 form over substance by incorporating § 506(a)  
21 determinations of secured status into the § 109(e)  
22 calculus, congressional intent seems little advanced by  
23 denying the benefits of Chapter 13 protection merely on  
the basis of a large quantity of unenforceable debt. Nor  
is this conclusion altered by the fact that the  
unenforceability of the debt arises by virtue of a prior  
Chapter 7 discharge.

24 208 B.R. at 787 (internal citations and quotations omitted).

25 Again, there appears to be no principled distinction between Chapter 12 and  
26 Chapter 13 eligibility when "importation" of §§ 506(a) and § 502(b)(1) is at  
issue.

1           The decision in Quintana is distinguishable from this case in  
2 that there, the Court held that, under Idaho law, the creditor was  
3 entitled to the full amount of its claim until a foreclosure sale  
4 had actually occurred, and the amount of any deficiency might be  
5 determined, stating, "until the actual sale of the property,...the  
6 amount of the debt is the full \$1,527,861.89 of adjudged  
7 indebtedness." 915 F.2d at 516. Here, the parties concede that  
8 Debtors had received their prior Chapter 7 discharge before the date  
9 of the filing of the petition, herein, rendering any unsecured  
10 portion of Farm Credit's claim unenforceable, hence, disallowed  
11 pursuant to § 502 (b)(1).

12           Next, Farm Credit argues Debtors have not met the "farming  
13 operation"<sup>13</sup> requirement of § 101(18)(A), in that they were not  
14 engaged in farming operations nor did they derive at least 50% of  
15 their gross income in 2003<sup>14</sup> from farming operations.

16           In In Re Sugar Pine Ranch, 100 B.R. 28 (Bankr. D. Or. 1989),  
17 this court held that "farming operation" should be given a broad or  
18 liberal construction. Id. at 31. Further, "[c]ourts should look to  
19 the totality of the circumstances involved in the debtor's operation  
20 bearing in mind the remedial purposes behind Chapter 12." Id. In so  
21 doing, some of the factors to be considered are:

- 22                   1. Whether the location of the operation would  
23                   be considered a traditional farm;

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25           <sup>13</sup> Under § 101(21), "'farming operation' includes farming, tillage of the  
26 soil, dairy farming, ranching, production or raising of crops, poultry, or  
livestock, and production of poultry or livestock products in an unmanufactured  
state."

<sup>14</sup> 2003 is the taxable year preceding the petition's taxable year.  
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- 1           2. The nature of the enterprise at the location;
- 2           3. The type of product and its eventual market...;
- 3           4. The physical presence or absence of family members on the farm;
- 4           5. Ownership of traditional farm assets;
- 5           6. Whether the debtor is involved in the process of growing or developing crops or livestock; and
- 6           7. Perhaps the key factor is whether or not the practice or operation is subject to the inherent risks of farming.
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8 Id. (internal citations and quotations omitted).

9           Here, applying the factors, the location of the operation is  
10 a traditional farm. The nature of the enterprise and type of product  
11 are the growing and harvesting of traditional crops. Bill was on the  
12 farm on a daily basis, maintaining the irrigation equipment and  
13 attending to other duties under the leases. True, debtors no longer  
14 own many traditional farm assets such as tractors, combines, balers  
15 etc., however, Bill, to a limited extent, contributed his labor to  
16 Woodman, and previously, to a greater extent, to Schultz. Finally,  
17 more than 340 acres are presently leased on a "share" basis under  
18 the Dunlea lease, where the lease payments are subject to the  
19 inherent risks of farming.

20           On balance, the court finds Debtors to be engaged in a  
21 farming operation, and further finds that they earned more than 50%  
22 of their gross income in 2003 from such operation.

23           Based on the above, Farm Credit's motion will be denied. An  
24 order consistent herewith shall be entered. The above constitutes  
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1 the court's findings of fact and conclusions of law. They shall not  
2 be separately stated.

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4 Albert E. Radcliffe  
5 CHIEF BANKRUPTCY JUDGE  
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